

United States General Accounting Office

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**GAO**

Report to the Chairman, Government  
Information, Justice, and Agriculture  
Subcommittee, Committee on  
Government Operations, House of  
Representatives

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December 1991

# FARMERS HOME ADMINISTRATION

## Debt Relief Actions for Business Entity Borrowers Are Questionable



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Resources, Community, and  
Economic Development Division

B-245443

December 10, 1991

The Honorable Bob Wise  
Chairman, Government Information,  
Justice, and Agriculture Subcommittee  
Committee on Government Operations  
House of Representatives

Dear Mr. Chairman:

The Farmers Home Administration (FmHA) has provided about \$2.8 billion in debt relief to delinquent borrowers under provisions of the Agricultural Credit Act of 1987. In your March 22, 1990, letter, you expressed concern that FmHA, in providing debt relief to corporations or partnerships (business entities), may not be obtaining or using current financial information for individuals who cosigned promissory notes for these business entity borrowers and accordingly may be granting more debt relief than warranted. Individual members of the business entity borrower usually cosign the loan and are therefore personally liable for the entity's FmHA debt.

Specifically, you asked us to (1) determine the number of business entity borrowers and the dollar value of their FmHA farm loans, entity borrowers who are delinquent and eligible for FmHA debt relief, and entity borrowers who have already received FmHA debt relief; (2) examine how FmHA county offices implemented the agency's April 1989 guidance, which clarified existing regulations on granting debt relief to business entity borrowers; and (3) determine whether FmHA recalculated the amount of debt relief provided to borrowers prior to issuance of the April 1989 guidance in order to minimize the government's losses in debt relief actions.

As agreed, because FmHA's farm loan portfolio does not distinguish between individual borrowers and business entity borrowers, we developed a list of the universe of business entity borrowers by conducting a computer search of FmHA's farm loan portfolio using key words associated with businesses. Using this list, we determined the number of delinquent entity borrowers eligible for debt relief and those entity borrowers who received FmHA debt relief. To examine FmHA county offices' implementation of the April 1989 guidance, we reviewed all business entity debt relief cases in one county office in each of the four

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states with the highest number of decisions on business entity debt relief. (See app. I.)

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## Results in Brief

As of March 31, 1991, FmHA held about \$1.8 billion in outstanding principal on farm loans for an estimated 7,664 business entity borrowers. About 44 percent of these entity borrowers—with outstanding principal totaling about \$1.2 billion—were delinquent and may be eligible for debt relief under the provisions of the Agricultural Credit Act of 1987. Between November 1988, when FmHA first began notifying delinquent borrowers of available debt relief options, and March 1991, an estimated 710 business entity borrowers had received FmHA debt relief—write-downs or write-offs—totaling about \$256 million.

The four FmHA county offices that we reviewed did not follow the April 1989 guidance. These county offices either did not obtain individual financial statements from all cosigners or obtained statements with incomplete or conflicting information. In about one-third of the 23 cases processed in these offices, county officials did not obtain the required financial information from all liable parties. In over two-thirds of the 23 cases, county officials did not follow up on or verify incomplete and/or conflicting data. Finally, even in those cases where FmHA county offices obtained some individual financial information from cosigners, FmHA officials were unsure about which personal assets and income to take into account and about the extent to which these assets and income could be used to repay the FmHA debt. County officials cited a variety of reasons for not following the regulations and guidance, including lack of time, insufficient understanding of the guidance, and/or their belief that because of their personal knowledge of the case, individual financial statements were unnecessary.

FmHA did not require county offices to recalculate debt relief decisions made prior to the April 1989 guidance. However, most of the business entity debt relief cases were decided after the April 1989 guidance was issued. About 90 percent of the 710 decisions were processed after the guidance. In the four county offices we visited, no final debt relief decisions were issued prior to the guidance.

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## Background

FmHA, an agency of the U.S. Department of Agriculture (USDA), is the federal lender to financially troubled farmers who cannot obtain credit elsewhere. When FmHA lends money to business entity borrowers, the

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individuals making up the entity usually cosign the loan, thereby becoming personally liable for the entity's entire debt.

The Agricultural Credit Act of 1987 (P.L. 100-233, Jan. 6, 1988) requires FmHA to notify borrowers who are at least 180 days delinquent about various debt relief options. These options include (1) restructuring loan terms, including writing down the debt, and (2) satisfying the debt by paying FmHA an adjusted value of the collateral securing the debt and writing off the remaining debt (referred to as net recovery value buy-out). The act also stresses that FmHA should attempt to keep those borrowers with viable operations on the farm while also minimizing farm loan losses to the government. FmHA uses a computer program—the Debt and Loan Restructuring System—to analyze a borrower's financial condition to determine the servicing options to be offered a borrower, including the amount to be restructured and the amount to be repaid. FmHA's state offices must approve all debt write-downs or write-offs before they can be made final. The state office review of such cases includes examining financial statements of all liable members of the business entity.

Although FmHA regulations have required for some time that a borrower's application for debt relief include current financial statements (within 90 days) from all individuals and entities liable for the debt, the regulations did not provide county offices with guidance on how to use this information in making debt relief decisions. Such guidance was provided in April 1989 through an administrative notice that was developed in response to a 1989 Office of Inspector General (OIG) report.<sup>1</sup> This report discussed problems concerning the use of individual personal financial statements when providing debt relief to business entity borrowers in California. For example, an individual associated with one business entity had personal assets, such as financial interests in a residential housing development and a hydroelectric project, that FmHA did not consider in deciding on debt relief. The OIG report concluded that FmHA county offices needed more specific guidance. Accordingly, in its April 1989 guidance, FmHA clarified its regulations by specifying that FmHA should not write down or write off an entity loan if the cosigner has other assets or income that could be used to repay the debt. It also provided additional instructions to county offices on how to use individual financial statements in considering debt relief.

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<sup>1</sup>Farmers Home Administration: FmHA Debt Restructuring for Delinquent Borrowers - Processing of Borrower Applications (Audit Report No. 04673-5-SF, Sept. 7, 1989).

A 1991 OIG report found that similar problems are continuing to occur.<sup>2</sup> According to the report, FmHA county offices were not properly considering the repayment ability of cosigners when determining the borrowers' funds available to service FmHA debt. County offices either had not received specific guidance for determining cosigners' repayment ability or did not properly determine it from the financial data provided by the cosigners. For OIG's sample, these problems resulted in about a \$505,000 understatement of funds available for four borrowers and about \$4.3 million more than was necessary in debt write-downs or write-offs.

The Food, Agriculture, Conservation, and Trade Act of 1990 (P.L. 101-624, Nov. 28, 1990)—referred to as the 1990 farm bill—required FmHA to write new regulations for debt relief decisions that will (1) take into account nonessential assets (those not essential for family living or farm operation and not exempt from judgment creditors or under bankruptcy law) in making the debt relief decision; (2) limit the amount of FmHA debt forgiveness a borrower can receive in a lifetime to \$300,000; (3) limit to one the number of write-downs or write-offs a borrower can receive on loans made after January 6, 1988; and (4) increase the time frame for processing FmHA debt relief applications from 60 to 90 days. The 1990 farm bill suspended debt write-down and write-off relief activity for loan-servicing applications received after passage of the bill until FmHA revises its program regulations to reflect the substantial changes made to its loan-servicing authorities. FmHA expects to issue regulations in December 1991.

## Nearly Half of Entity Borrowers May Be Eligible for Debt Relief

As of March 1991, over 4 percent of FmHA farm loan borrowers were business entity borrowers, who held almost 10 percent of the total outstanding unpaid farm loan principal, according to our estimates. About 44 percent of business entity borrowers were delinquent and may be eligible for FmHA debt relief. Table 1 compares information on the status of loans held by all FmHA farm loan borrowers with the status of loans held by business entity borrowers.

<sup>2</sup>Farmers Home Administration: Debt Restructuring, Selected Large Borrowers (Audit Report No. 04673-9-SF, Sept. 19, 1991).

**Table 1: Status of Total Farm Loan Borrowers and Business Entity Borrowers as of March 31, 1991**

Dollars in billions

Type of borrower	Number of borrowers	Unpaid principal outstanding	Delinquent borrowers		Unpaid principal outstanding
			Number	Percent	
All farm loans	177,913	\$18.2	61,008	34.3	\$9.6
Business entity	7,664	1.8	3,349	43.7	1.2

Source: GAO analysis of FmHA data.

An estimated 710 business entity borrowers received about \$256 million of FmHA debt relief between November 1988 and March 1991. Table 2 shows the type, number, and amount of FmHA debt relief received by business entity borrowers as of March 1991.

**Table 2: Business Entity Borrowers Who Received FmHA Debt Relief as of March 31, 1991**

Type of relief	Number of borrowers	Total debt relief (in millions)	Average debt relief	Range of debt relief
Write-down	308	\$94.6	\$307,000	\$1,100 to over \$5 million
Write-off	402	161.4	401,000	\$8,400 to over \$4 million
<b>Total</b>	<b>710</b>	<b>\$256.0</b>		

Source: GAO analysis of FmHA data.

Generally, business entity borrowers who received debt write-downs are still active FmHA borrowers. Entity borrowers who received debt write-offs are no longer active FmHA borrowers, unless FmHA subsequently granted them new loans.

## County Offices Did Not Follow FmHA Guidance

The 4 FmHA county offices we visited provided about \$8 million in debt relief to a total of 23 business entity borrowers. These borrowers received either restructuring with debt write-downs or net recovery value buy-outs with debt write-offs. However, in providing such debt relief, these offices generally did not follow FmHA regulations and the 1989 guidance. Specifically, they did not always obtain the required individual financial statements or, when obtained, did not review the statements for accuracy and completeness. Also, they did not fully understand how to consider personal assets and income in deciding on debt relief. These problems were not identified by the FmHA state offices during their review and approval of the debt relief decisions. As a result, FmHA cannot be assured that business entity borrowers received the appropriate amounts of debt relief.

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## Financial Statements of Individual Cosigners Not Obtained

FmHA's April 1989 policy guidance states that borrowers' debt relief applications are to be rejected as incomplete if all liable individuals and entities do not provide financial statements. In the case of business entity borrowers, this would include obtaining financial statements from both the entity and the individuals who cosigned the loans. However, 8 of the 23 cases we examined lacked the required personal financial statements; yet neither the FmHA county offices nor the state offices rejected the debt relief applications. In six of the eight cases, the county offices did not obtain any personal financial statements, and in two cases, some but not all personal financial statements were obtained from all liable individuals of the entity.

County officials did not follow FmHA regulations requiring financial statements from all liable parties for a variety of reasons. One county supervisor stated that he was aware of the requirement to obtain individual financial statements but did not obtain them for any of the four entity borrowers who received debt relief. He explained that, because of his personal knowledge of the individuals in the entity, the information reported on the entity's financial statements was adequate and that personal financial statements from the individual members would not disclose any additional assets or income that could be used to repay the FmHA debt. Other county supervisors were unaware of the requirement to obtain individual financial statements prior to the issuance of the guidance or stated that they lacked the time to obtain such statements, given their heavy loan-making and debt-servicing caseload and the mandated time frames for processing the cases.

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## Accuracy and Completeness of Reported Financial Statements Not Ensured

The four county offices we examined were not reviewing individual cosigners' financial statements for completeness and accuracy. Even in the 17 cases where county offices obtained financial statements from some or all liable parties, the statements often were incomplete or contained conflicting information, particularly regarding nonfarm income and assets. Currently, FmHA regulations require county offices to verify nonfarm income and liability information with employers and creditors. However, there are no similar requirements for verifying nonfarm assets and expenses, nor does FmHA require county offices to use credit reports, tax information, or other possible sources of information verification. Three county supervisors believed that nonfarm assets and expenses should be verified but stated that the time frames for processing cases did not allow for verification.

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The following cases illustrate the types of incomplete or conflicting information that we found in business entity loan files. FmHA county offices and state offices approved debt relief for these borrowers despite these problems.

Case 1: FmHA approved a debt write-off totaling about \$191,000 for this entity borrower. However, the loan files indicated that there might have been other personal assets that should have been considered and that might have reduced the debt relief. This entity, with two partners, provided only a joint individual financial statement that was essentially a copy of the partnership's financial statement. The partners attached a note stating that the assets listed were all they had as partners. The county supervisor accepted this financial statement, although he knew that the partners lived part of the year in another state, reported non-farm income (\$10,000) from a business located there, and, consequently, might have other assets or additional income to report. The county official acknowledged that the financial statements were sparse but believed they were adequate. He did not attempt to follow up to determine if the borrowers' nonfarm business had other assets or income that should have been considered in the debt relief process. We examined property records in the other state and found that the partners had made a down payment of about \$30,000 on a house, which was valued at \$150,000, within 1 year after their FmHA debt was written off.

Case 2: This business entity received a FmHA debt write-off totaling about \$1.5 million. Again, loan files indicated that there might have been personal assets that should have been considered in deciding on debt relief. More specifically, the loan files indicated that in 1985 the borrowers owned diamond jewelry and a mink coat that were insured for more than \$41,000. The current county supervisor was unaware that the entity borrower owned these personal assets.

Case 3: FmHA approved a debt write-down totaling about \$46,000 for this entity borrower. However, the borrower's loan files showed that substantial nonfarm income (\$43,000 annually for each of the two partners) was matched by expenses. This raised questions about the accuracy of the data. Additionally, we found other instances of inconsistencies. For example, one partner listed homeowner expenses but did not show a home as an asset. The county official believed that the partner probably rented but was unable to explain the lack of any reported rental expense. He acknowledged that the borrowers' expenses probably should be verified but believed that the 60-day time frame for processing debt relief requests did not allow for verification.

**Case 4:** This business entity, which did not submit personal financial statements, received a \$91,000 debt write-off. However, loan files indicated that four of the cosigners had nonfarm income that had not been considered in the debt relief decision. The county official was unaware of the nonfarm income but believed that it would not have materially affected the debt relief decision.

## Uncertainty Over Treatment of Assets and Income

FmHA county officials are uncertain about how to consider the individual assets of a cosigner in the debt relief process. FmHA's April 1989 guidance states that if individual personal financial statements indicate there are other assets or income that could be used to repay the debt, the assets should be applied to reduce the debt before computing the debt relief, and the income should be added to the amount available to make payments during the debt relief calculations. However, FmHA county officials for the three counties that obtained financial statements informed us that they were unsure about which assets to use in the debt relief process—all personal assets or only certain nonessential assets—or, as illustrated below, how to consider them.

For example, one business entity received \$46,000 in debt relief on four loans. However, county loan files indicated that one of the cosigners had substantial personal assets (an accounting firm and farm property) that could have been applied to reduce the debt relief. Although the county official was aware of these assets, he was unsure how they could be used to offset the debt relief offered the entity. As a result, the official did not use the full value of the personal assets to reduce the borrower's FmHA debt. Instead, the county official, with the approval of the state office, assigned a value to the cosigner's personal assets that might, or might not, have been a fair representation of the cosigner's ability to repay the loan. Not considering the full value of the borrower's personal assets may have resulted in up to \$23,000 of unwarranted debt relief.

## Debt Relief Was Generally Not Recalculated

FmHA did not require county offices to recalculate debt relief decisions that were made before the April 1989 guidance. Of the estimated 74 business entity cases that received debt relief before the 1989 guidance, none were processed in the 4 county offices we visited.<sup>3</sup> Therefore, the county offices had not recalculated the debt relief provided prior to the 1989 guidance. Furthermore, they do not plan to recalculate the debt

<sup>3</sup>Most of the debt processing for two cases took place before the guidance was issued. However, the final decisions were made afterwards.

relief provided in the cases we reviewed. County officials stated that recalculating debt relief would not be worthwhile because proper debt relief procedures were followed, or when they were not, the borrowers would not have had sufficient additional personal assets or income to change the type or amount of FmHA debt relief.

For some cases identified by the OIG, FmHA is recalculating past debt relief decisions. Additionally, the OIG recently reported<sup>4</sup> that FmHA county offices are unsure when to revise debt relief decisions that contain errors. On the basis of the OIG's preliminary findings, FmHA issued guidance to its county offices in February 1991 outlining actions that offices should take when they identify debt write-down cases where errors occurred. This guidance pertains only to correcting errors in debt write-down cases, not to buy-out cases with debt written off. While FmHA does not question its authority to seek such recovery, it believes that recovery of any unauthorized debt relief from borrowers whose debts were written off entirely would be difficult because they are no longer active FmHA borrowers and, consequently, FmHA lacks leverage over them.

## Conclusions

FmHA is responsible for providing debt relief to the business entity borrower in a manner that is fair to the borrower and, at the same time, minimizes the federal government's losses. For these purposes, it needs accurate information on the borrower's financial condition. However, as the OIG reported in 1989, FmHA county offices either were not obtaining or properly using personal financial statements of individual members of business entity borrowers when deciding on debt relief. Similarly, in the county offices we reviewed, debt relief decisions were approved without the required individual financial statements from cosigners or with incomplete or conflicting information, particularly pertaining to nonfarm income or assets that should be used to reduce the level of debt forgiveness. For the most part, county offices accepted any financial information that was submitted by the entity borrower and cosigners, and did little to verify the information or follow up on data that were incomplete or conflicting. Furthermore, even when personal assets and income were accounted for, county officials were not always certain about the extent to which such assets and income should be considered in the debt relief decision. These problems raise questions as to whether the county offices granted the appropriate amount of debt relief in each

<sup>4</sup>Farmers Home Administration: Debt Restructuring for Delinquent Borrowers, Implementation of Primary Loan Service Programs (Audit No. 04673-7-SF, June 27, 1991).

of the cases they processed. Furthermore, the problems we found were not identified in the state office review.

Many entity borrowers are currently delinquent and could be eligible for substantial amounts of debt relief over the next few years. This increases the importance of using accurate financial information in future debt relief decisions. However, FmHA has already granted over \$250 million of debt relief to business entity borrowers, some of which, we believe, is questionable. While FmHA issued February 1991 guidance directing county offices to correct errors in debt write-down decisions once they are identified, it did not require a systematic review to identify errors. Furthermore, this guidance does not address debt write-off cases. We believe that reviewing prior write-down and write-off decisions is unlikely to unduly burden individual FmHA county offices because of the small number of cases processed—710 spread among approximately 1,900 county offices.

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## Recommendations to the Secretary of Agriculture

We recommend that the Secretary of Agriculture direct the Administrator, Farmers Home Administration, to take the following actions:

- Issue guidance emphasizing the necessity of obtaining complete personal financial statements from all individual cosigners of business entity loans requesting debt relief and of verifying the accuracy of the information, particularly nonfarm income, assets, liabilities, and expenses. Sources for verification could include credit reports, tax information, and record checks at local banks and county courthouses.
- Specify which personal assets and income county offices should consider in providing debt relief to business entity borrowers.
- Require FmHA county offices to review prior debt write-down and write-off decisions for business entity borrowers, identify those decisions in error, and pursue recourse when errors are identified. FmHA may want to consider the potential recovery amount in deciding whether to pursue recovery.

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## Agency Comments and Our Evaluation

FmHA generally agreed with our concerns about its process for providing debt relief to business entity borrowers. Overall, FmHA stated that our concerns should be adequately addressed when it issues its final regulations implementing the 1990 farm bill. As stated earlier, FmHA expects to issue regulations in December 1991.

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With respect to our recommendation that FmHA obtain complete personal financial statements from all cosigners and that it verify the accuracy of the information, FmHA stated that the new regulations will address this issue. The regulations will extend the time frame for processing debt relief applications from 60 days to 90 days and allow more time for FmHA county supervisors to obtain and verify financial statements. Furthermore, FmHA stated that the new regulations will authorize the agency to order commercial credit reports if needed to verify information submitted by business entity borrowers. These are steps in the right direction, but they will not completely address the problems. Specifically, time constraints did not always appear to be a problem for those county offices we visited that did not attempt to obtain required financial statements from all cosigners of entity loans or verify the existence of other cosigner assets. We believe this reflects a lack of importance that some FmHA county offices attach to adhering to existing debt relief regulations. Accordingly, FmHA should reemphasize the importance of obtaining and verifying financial information from all business entity cosigners.

Concerning our recommendation that FmHA specify the personal assets and income to consider in providing debt relief, FmHA noted that it had faced several legal hurdles in implementing the April 1989 guidance about the consideration of a borrower's other assets and income. However, FmHA stated that changes made in the 1990 farm bill will help to address these problems and that the new regulations implementing the 1990 farm bill will require that FmHA consider a borrower's nonessential assets in deciding on debt relief.

Concerning our recommendation that FmHA identify prior debt relief decisions for business entities that contain errors and pursue recourse, FmHA agreed to review the cases we identified. However, it noted that it may be difficult to seek recovery in net recovery buy-out cases where entity borrowers received debt write-offs and are no longer FmHA borrowers. As FmHA requested, we provided the agency with a listing of the names and case numbers for over 700 business entity borrowers we identified that had received FmHA debt relief as of March 31, 1991. (See app. II.)

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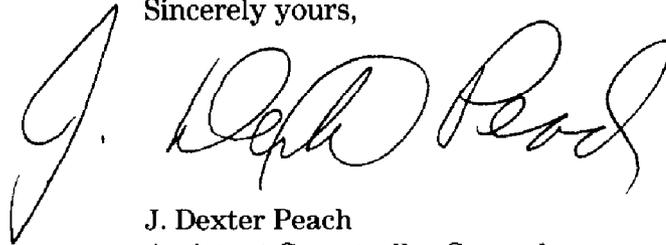
We conducted our work between October 1990 and June 1991 in accordance with generally accepted government auditing standards.

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As arranged with your office, unless you publicly announce its contents earlier, we plan no further distribution of this report until 30 days after the date of this letter. At that time, we will send copies to appropriate Senate and House committees; interested Members of Congress; the Secretary of Agriculture; the Administrator, FmHA; the Director, Office of Management and Budget; and other interested parties. We will also make copies available to others upon request.

This work was performed under the direction of John W. Harman, Director, Food and Agriculture Issues, who may be reached at (202) 275-5138 if you or your staff have any questions. Other major contributors to this report are listed in appendix III.

Sincerely yours,

A handwritten signature in black ink, appearing to read "J. Dexter Peach". The signature is written in a cursive style with a large initial "J" and a long, sweeping underline.

J. Dexter Peach  
Assistant Comptroller General



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## Abbreviations

FmHA	Farmers Home Administration
GAO	General Accounting Office
OIG	Office of Inspector General
USDA	U.S. Department of Agriculture

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# Objectives, Scope, and Methodology

On March 22, 1990, the Chairman, Government Information, Justice, and Agriculture Subcommittee, House Committee on Government Operations, requested that we review the Farmers Home Administration's (FmHA) implementation of the debt restructuring provisions of the Agricultural Credit Act of 1987 as they relate to borrowers who are business entities, such as corporations or partnerships. On the basis of the Chairman's request and subsequent discussions with the staff, we

- determined the total number of business entity borrowers, the dollar value of their FmHA farm loans, and those entity borrowers eligible for debt relief under the 1987 act,
- examined FmHA's county office implementation of the April 1989 policy guidance that clarified the process of granting debt relief to business entity borrowers, and
- determined whether FmHA used the April 1989 guidance to recalculate the amounts of debt relief that had been provided prior to the issuance of the guidance.

The computerized data bases for FmHA's farm loan portfolio cannot differentiate between an individual and a business entity borrower. Therefore, we performed key word searches of FmHA's data bases for all farm program borrowers as of June 30, 1988, and again as of March 31, 1991, in order to estimate which borrowers were business entities, the number of such borrowers and the dollar value of their FmHA farm loans, and those business entity borrowers subject to debt relief. For the key word search, we compared FmHA farm loan borrower names to a list of about 80 words that might indicate a business entity. We developed our list of key words on the basis of our prior work and FmHA input, and included, for example, such words as partner, corporation, farms, and dairy. From the resulting universe of business entities, we identified those which had received debt relief.

FmHA loan services are provided through a highly decentralized organization consisting of a national program office in Washington, D.C., a finance office in St. Louis, Missouri, and a field structure of 46 state offices, about 260 district offices, and about 1,900 county offices throughout the nation. To examine FmHA's implementation of regulations and program guidance, we sorted the business entities that had received debt relief by state and identified the four states with the highest number of such borrowers whose loans were written down and written off—Arkansas, Georgia, Michigan, and Minnesota. Within each of those four states, we identified the county office that had the highest number of business entities with loans written down and written off. The

number of such cases in the 4 FmHA county offices we reviewed ranged from 4 to 10.

In Michigan, three counties tied for the highest number of business entity debt relief cases. Consequently, we selected from these three the county with the highest amount of debt relief granted. We visited each county office and reviewed all loan-servicing case files for business entities to determine if they had been processed in accordance with FmHA policies, regulations, and guidance.

To determine whether FmHA had recalculated any debt relief granted to business entities before the issuance of the April 1989 policy guidance, we interviewed FmHA headquarters' officials, state office officials, and county supervisors to obtain information on the processing of business entity cases and to determine whether any cases processed before the issuance of policy guidance had been recalculated.

To compile general information on FmHA's servicing of business entity borrowers, we reviewed statutes, regulations, policies, and guidance. We also reviewed the 1990 farm bill to determine its intended impact on loan servicing of business entities. In addition, we interviewed FmHA headquarters officials concerning debt relief granted to business entity borrowers.

The results of our work at the four FmHA county offices cannot be projected to the states we reviewed or to the nation overall. We conducted our review from October 1990 through June 1991 in accordance with generally accepted government auditing standards.

# Comments From the U.S. Department of Agriculture



United States  
Department of  
Agriculture

Farmers  
Home  
Administration

Washington  
D.C.  
20250

OCT 17 1991

SUBJECT: U.S. General Accounting Office Draft Report RCED-92-29, "FmHA: Questionable Debt Relief Actions for Business Entity Borrowers"

TO: John W. Harman  
Director  
Food and Agriculture Issues

We wish to thank you for giving us the opportunity to comment on the draft of the subject GAO report. Our points of clarification are as follows:

See comment 1.  
Now on p. 3.

(1) On page 3, the last paragraph should be changed to state that the Agricultural Credit Act of 1987 "required FmHA to notify borrowers who are at least 180 days delinquent about various debt relief options."

See comment 1.  
Now on p. 4.

(2) On page 5, the last paragraph oversimplifies the changes made by the Food, Agriculture, Conservation and Trade Act of 1990 (FACT Act). The paragraph should be changed, in part, to read:

... (1) take into account nonessential assets, those not essential for family living or farm operation and not exempt from judgment creditors or under bankruptcy law, in making the debt relief decision; (2) limit the amount of FmHA debt forgiveness a borrower can receive in a lifetime to \$300,000; (3) limit the number of write-downs or write-offs a borrower can receive on loans made after January 6, 1988 to one...

See comment 2.

(3) On page 13, the draft report addresses the possibility of recovering in cases where calculation errors were made in granting net recovery buyouts (NRBs). Such a proposition would be difficult legally because in NRB situations the promissory notes are marked satisfied and returned to the debtor or debtor's representative. FmHA, thus, would have no legally enforceable instrument on which to base a claim for further payment on the debt.

See comment 3.

(4) Throughout the draft report reference is made to county supervisors' obligation under an April, 1989 administrative notice (AN) to consider a co-signer's other assets and income which could be used to repay the FmHA debt. Before passage of the FACT Act, we faced several legal hurdles in implementing the policy set forth in the AN. We could only consider the value of security, not other unencumbered assets, in establishing the net recovery value. The net recovery value is compared to the value of the restructured debt in determining whether a borrower can cash flow with restructuring or whether NRB should be offered. FmHA conceivably could have used the existence of other assets to find the borrower ineligible for restructuring because the

See comment 4.



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Complaints of discrimination should be sent to:  
Secretary of Agriculture, Washington, D.C. 20250

Appendix II  
Comments From the U.S. Department  
of Agriculture

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delinquency was not due to circumstances beyond the borrower's control.

See comment 5.

This was difficult to prove because in most situations the borrowers had experienced losses from their farming operations. Even if restructuring were denied, it would have been difficult to collect the other income or the value of the other assets on which FmHA did not have a lien.

See comment 2.

Many changes made by the FACT Act (mentioned on page 5 of the draft report) will help us address the concern of GAO that FmHA consider the other assets of co-debtors in making restructuring and NRB decisions. These changes will be implemented by agency regulation. The statute revised the section on restructuring eligibility criteria to state that a borrower will not be eligible for restructuring if certain nonessential assets exist which could be used to bring the account current. The statute also prohibited the write-down or write-off of debt which could be paid through the use of these assets. The value of the assets also are included in net recovery value. The extended timeframe for processing applications (90 days) will allow the county supervisors more time to obtain and verify complete financial records of borrowers and co-signers. The regulations will provide for ordering commercial credit reports on Farmer Program entity borrowers.

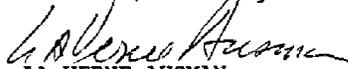
See comment 2.

We emphasize that GAO's concerns should be adequately addressed when the regulations implementing the FACT Act are issued as final rules.

See comment 2.

To follow-up on the findings in the draft report, we request GAO to provide us with a list of the 710 cases identified and mentioned in the draft report, including borrowers' names and case numbers. We will arrange to have the cases reviewed and take any necessary actions that are appropriate for the discrepancies found.

We appreciate the opportunity to comment on the GAO Report before it is released in final form. If you have any questions concerning our response, please contact Leonard Hardy, Jr., Director, Planning and Analysis Staff at 475-5300.

  
LA VERNE AUSMAN  
Administrator

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The following are GAO's comments on the October 17, 1991, letter from the U.S. Department of Agriculture.

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## GAO Comments

1. We made factual changes to the report.
2. We addressed this point in our discussion of agency comments and our evaluation.
3. The fact that FmHA could not in 1989 consider unencumbered assets in determining net recovery value is not relevant to FmHA's overall debt relief decision. The limitation on considering a borrower's unencumbered assets applied only to the technical calculation of the net recovery value of the collateral securing the loan. Prior to making such a calculation, however, FmHA could have taken unencumbered assets into account in (1) determining the borrower's ability to repay the FmHA debt and in (2) deciding on what debt relief options could be offered to the borrower.
4. With regard to debt delinquency due to circumstances beyond a borrower's control, FmHA is not, as its comments appear to recognize, precluded from considering a borrower's nonfarm resources when determining the amount of debt relief.
5. The fact that FmHA may have to sue a borrower in order to reach the borrower's unencumbered assets is not a serious obstacle. Such law suits may simply take more time than the process to enforce liens on the borrower's secured assets.

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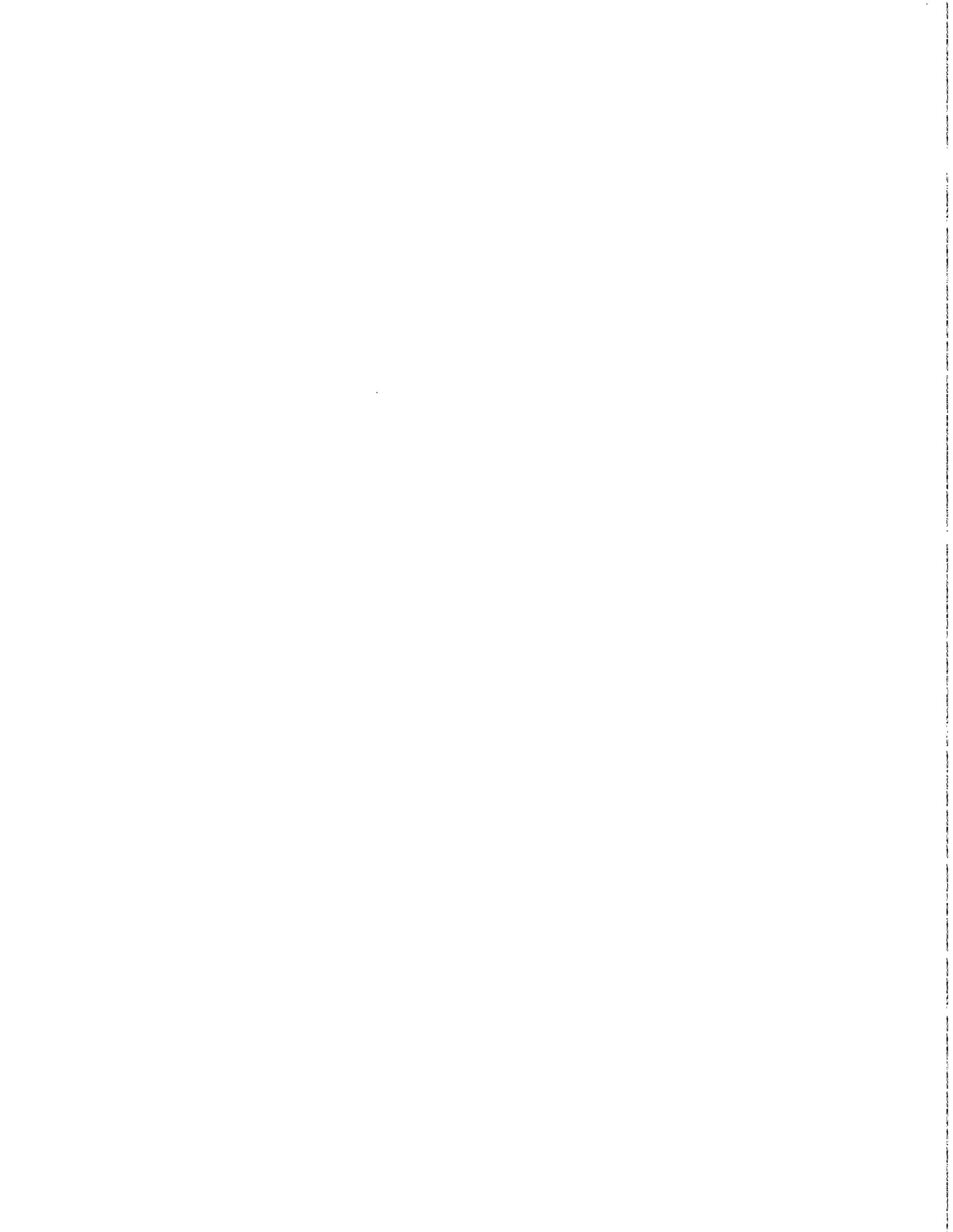
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